
Does Identification with the Firm and Profession Mitigate Outcome Effect on Auditors' Decisions?

Assistant Prof.
Anna J. JOHNSON-SNYDER, Ph. D.,
East Carolina University, U.S.A.,
e-mail: johnsonan18@ecu.edu

Associate Prof.
Brenda L. KILLINGSWORTH, Ph. D.,
East Carolina University, U.S.A.,
e-mail: killingsworthb@ecu.edu

Abstract

The paper examines whether auditors' identification with the organization or with the profession will influence the use of outcome knowledge when reviewing audits. In addition, the study examines whether the conflict between organizational identity and professional identity influences evaluators' use of outcome knowledge. The study participants consisted of 63 auditing experts in managerial ranks. Auditors completed an instrument containing randomized audit review scenarios developed to evaluate the effects of identification and outcome knowledge on decisions. Results showed that organizational identification can minimize the effect of outcome knowledge on decisions while professional identification results in an increase in biases.

Keywords: auditor judgement; organizational identification; professional identification; organizational-professional conflict; outcome knowledge; audit

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Introduction

Information, in general, comes in various forms and at various times, including *ex-post* of the completion of an audit. In the auditing environment, whether conducting an internal or external review, an auditor will try to make the best decision based on the information that is available at the time. Auditing is a very litigious environment. When an unanticipated event occurs that results in a legal issue, some evaluators forget or overlook the fact that only certain information was available prior to the event and, instead, use the event information to work backward in assessing the information (Anderson, Lowe, and Reckers, 1993). Peecher and Piercey (2008) argue that some evaluators who “were not at the audit,” may not be familiar with an auditor’s decision process and have “uncertain and incomplete information” (p. 246). Hence, it seems logical that an evaluator should use the same information that was available to the auditor to assess the auditor’s judgement. This is also in line with maintaining professional skepticism and objectivity when making a decision (Bunget, Tudor, and Sumanaru, 2019).

Evaluators, however, continue to use outcome information as part of the evaluation process (e.g., Emby, Gelardi, and Lowe, 2002; Brazel, 2018), resulting in a biased assessment influenced by information not available for the original audit. For example, although judges are trained to follow the logical path of the information or evidence, prior research has found that some judges still use the outcome information to make their judgement (Jennings, Lowe, and Reckers, 1998). The use of *ex-post* information doesn’t align with international standards for auditing. Case in point, the International Accounting Standards Board sets IFRS Standards which state that, “Hindsight should not be used when applying a new accounting policy to, or correcting amounts for, a prior period...” (IAS 8, paragraphs 53, 2018a, p. 53) and also offers direction on how to make materiality judgements about prior-period information (IFRS Practice Statement 2, 2017).

Another source of bias in auditing is an auditor’s degree of identification with the organization (Bamber and Iyer, 2002). International and national standards organizations alike stipulate or encourage that auditing decisions be based on evidence and not biased by an auditor’s relationships. For instance, IFRS Standards require an organization to disclose any related party

relationships that might influence the independence of the financial statement audit (IAS 24, 2018b). Similarly, the Sarbanes-Oxley Act of 2002, a law passed by the U.S. Congress, forbids accounting firms from offering some consulting services to firms that they also audit (U.S. House of Representatives, 2002). This law was designed to protect individuals investing in companies from fraud and to help improve the reliability of corporate financial reports in the wake of a wave of high-profile corporate crime incidents in the United States. Yet, even with these guidelines and laws in place, studies have shown that organizational influences do exist and can bias auditor judgements (e.g., Bazerman, Loewenstein, and Moore, 2002).

Both sources of bias, organizational identification and outcome knowledge, should be avoided to maintain professional standards and independence. However, the use of outcome knowledge to assess another expert’s audit is of special concern in this paper. When auditors use outcome knowledge to assess *ex-post* another audit, then the original audit is taken out of the context in which it was conducted. Using outcome knowledge will result in an inaccurate assessment of the original audit performed and unduly place additional response burdens on the firm. For instance, ISO 9001:2015 mandates management to make certain corrective action is taken to address any nonconformities uncovered in the course of an audit (International Standards Organization, 2015). Further, experts tend to be more strongly influenced by negative outcome knowledge. Finally, biases resulting from the use of outcome knowledge has been shown to magnify the relative salience of outcome-consistent information (Emby, Gelardi, and Lowe, 2002). This magnification of negative outcome knowledge, especially when used during an external audit, can have serious financial and legal ramifications.

The purpose of this paper is to examine whether an auditor’s identification with the firm or with the profession will influence an evaluator’s use of outcome knowledge when reviewing another auditor’s decision. Further, the paper examines whether a conflict between these two identities (professional and organizational) will influence the use of outcome knowledge in an evaluator’s evaluation of another’s decision.

The research contributes to the outcome knowledge and hindsight bias literature in assessing identification and outcome knowledge factors that impact an auditor’s

judgements. In the ensuing section, we draw on extant research in outcome knowledge and identification to expand on the field's understanding of how these factors influence auditors' review of other auditing experts' judgements and to develop our hypotheses. Then, we present an empirical study that tests the research hypotheses using an instrument containing randomized scenarios developed to evaluate the effect of identification and outcome knowledge on auditors' judgements. We conclude with an identification of the study's limitations and a discussion of theoretical and practical implications of the study's findings on ways to mitigate the use of outcome knowledge when an auditor reviews an audit.

1. Literature review

1.1. Outcome Knowledge

Outcome effects occur when an evaluator's judgement is unfavorably (favorably) swayed by negative (positive) event outcome information (Peecher and Piercey, 2008; Emby, Gelardi, and Lowe, 2002). Prior research shows that negative outcome knowledge has a higher impact on evaluators' objectivity than positive outcome knowledge (Emby, Gelardi, and Lowe, 2002; Lowe and Reckers, 2002; Peecher and Piercey, 2008). However, other factors may mitigate the skewed perception resulting from outcome knowledge.

Research shows that judgements of highly trained professionals are impacted by negative outcome knowledge. For instance, although trial judges are trained to exercise due professional care, research reveals that they "consistently overestimate the probability of a known outcome" (Jennings, Lowe, & Reckers, 1998, p. 148). In other words, judges' ability to objectively evaluate an auditor's performance retrospectively fades depending on the adverse information. Anderson, Lowe, and Reckers' (1993) study suggest that evaluators focus on the given event outcome and use this knowledge to work backward to the antecedent factors consistent with the outcome.

Prior to Peecher and Piercey's (2008) study, other studies used variables to control for the outcome effect but failed to measure the impact of the outcome effect and reverse outcome bias. Peecher and Piercey used two experiments to replicate the outcome effect, i.e.,

both hindsight and foresight, from prior audit failure studies to examine undergraduate students' assessment of auditor negligence. Participants' judgements exhibited outcome bias when the probability of negligence fell below 40 percent yet exhibited reverse outcome bias when the evidence supported a probability higher than 40 percent. In essence, if the outcome information in the experimental scenario crossed an invisible line of 40 percent probability, the students' judgements would shift to the direction that was presented in the outcome information.

Prior to performing the current year audit, auditors review the working papers for the prior year audit and any available information. This is a continuous learning environment where an evaluator will review the information at a much later date than when the prior year audit was performed. More information, including event outcome information, is available in the later period that wasn't available while the prior year audit was in progress. As of this writing, no prior study has examined whether the outcome effect, the impact of the outcome information on a decision, is minimized by auditors' identification.

1.2. Identification

Prior literature finds that identification influences accounting professionals in a number of ways. Former accounting employees are likely to recommend business to their former employer (Iyer, 1998) and use their services (Herda and Lavelle, 2011). An auditor is likely to underreport his actual work hours on a project when he identifies with a client (Bamber and Iyer, 2007). Of interest in this paper is King's (2002) study that examines the level of social identity among auditors.

King (2002) investigated the judgements of 44 manager and auditor pairs, played by business-school students, to measure self-serving biases using an audit trust game. Within the game, managers communicated different messages in which either did or did not lead auditors to form biased opinions toward managements' intentions. The author finds that auditors do have self-serving biases, but the bias is mitigated by their identification with the audit group. These findings are of interest to us because other debiasing techniques have not always been successful in minimizing the impact of outcome information.

Prior literature on outcome effect suggests that outcome information still influences individuals' judgements

although debiasing techniques have been implemented. Previous research on identification supports identification may be another way to minimize the impact of the outcome effect. Hence, in this paper, we posit and examine whether the outcome effect is mitigated by auditors' various types of identification.

H1: Outcome bias will be higher for subjects with higher organizational identification.

H2: Outcome bias will be lower for subjects with higher professional identification.

H3: Outcome bias will be lower for subjects with higher identification conflict of organization.

Consistent with prior literature that adverse outcome knowledge negatively impacts an individual's judgement (Peecher and Piercey, 2008), we expect outcome knowledge to impact auditors' judgements. However, we predict that the outcome effect will be higher for auditors with higher levels of organizational identity while we expect the outcome effect will be lower for those with higher professional identity. Further, we predict that the outcome effect will be lower for auditors experiencing a higher level of identity conflict between the organization and profession.

2. Research methodology

2.1. Method

An Analysis of Variance (ANOVA) is used to examine whether the outcome effect is mitigated by identification

when making a decision. SPSS® Statistics version 26, was used for analyzing the data. Decision (DECISION) was operationalized by asking participants their level of agreement with the lead engagement partner's decision to accept management's claim. All variables, except for OUTCOME, were assessed using a 7-point Likert-type scale where "1" represented "Strongly Disagree" and "7" represented "Strongly Agree." In this study, the variables of interest are OUTCOME, ID_ORG, ID_PRO, and ID_CONFLICT.

Outcome knowledge (OUTCOME) was operationalized by manipulating positive and negative outcome information within an instrument. In the scenario, management assumed a higher growth rate in calculating a business valuation and goodwill impairment that were semi-dependent on a new product line. The negative outcome informed participants that the reporting unit's sales did not meet management's projections, and the positive outcome stated that the reporting unit's sales projections were met. Half of the participants received an instrument with negative outcome information and the other half received an instrument with positive outcome information. Identification was operationalized by using three questions to assess subjects' identification with the organization (ID_ORG), identification with the profession (ID_PRO), and whether there was a conflict between the two identifications (ID_CONFLICT). Participants were asked to select their level of agreement on the statements presented in **Table no. 1**.

Variable	Statements
ID_ORG	I would recommend my current employer to my friends and family who are searching for a job. (Question 20)
ID_PRO	As a whole, I would recommend entering the accounting industry to my friends and family who are searching for a profession. (Question 21)
ID_CONFLICT	I would consider changing jobs before a mandatory retirement age. (Question 19)

Source: Authors' survey, ID_ORG adapted from Tropp & Wright, 2001

Each survey was presented in a specific sequence. First, participants were presented a welcome and informed consent page. Second, the Qualtrics software randomly assigned participants to different scenarios. Third, all subjects were given identical situational information on a goodwill impairment scenario,

an audit memorandum, and five supporting working papers. Next, participants were provided one of two random outcomes. Finally, each participant was given an identical questionnaire. Approximately half of the participants were given negative information while the other half were given positive information.

2.2. Data

Considering we needed auditor participants to complete the survey, a number of methods were used to contact potential participants within the United States. First, surveys were sent to personal contacts of the authors, mentors, and friends. We also asked the contacts to not only complete the survey but to share the survey with their coworkers and friends. Second, additional participants were contacted who had connections to the university. Finally, both a request for participants and a link to the survey were posted on a professional society's LinkedIn page for one week. Data were collected between November 2013 and March 2014. The survey was attempted by 121 participants but only

completed by 82. Manipulation checks were used to assess whether participants could identify the randomly assigned outcome information and were familiar with the scenario topic. Only 63 surveys remained after those by participants who failed the manipulation checked were removed. Of the 63 participants, 29 (46.03%) received the scenario where outcome information was positive while 34 (53.97%) participants received the scenario in which outcome information was negative.

All participants were in managerial rank in an accounting firm. Specifically, participants were 5 (7.94%) accounting firm owners, 40 (63.50%) partners, 4 (6.35%) directors, 6 (9.52%) senior managers, and 8 (12.70%) managers (See **Table no. 2**).

Table no. 2. Participant Title

Title of Survey Participants	Number of Participants	Percentage of Participants
Manager	8	12.70%
Senior Manager	6	9.52%
Director	4	6.35%
Partner	40	63.50%
Owners	5	7.94%

Source: Authors' processing based on surveyed auditors' responses

3. Results

3.1. Analysis of Variance (ANOVA)

We performed an Analysis of Variance (ANOVA) to evaluate the hypotheses. The ANOVA results are presented in **Table no. 3**. Overall, we find that

OUTCOME and ID_ORG were statistically significant ($p = 0.05$ and $p = 0.01$, respectively), and ID_PRO was marginally significant ($p = 0.10$). ID_CONFLICT was not significant. Based on these results, we performed a more in-depth review of the group differences (OUTCOME) across ID_ORG and ID_PROF.

Table no. 3. Analysis of Variance (ANOVA)

Dependent Variable: DECISION					
Source	Type III Sum of Squares	Df	Mean Squares	F	Sig.(one-tailed)
Corrected Model	24.64 ^a	4	6.16	2.65	0.02
Intercept	3.10	1	3.10	1.33	0.13
OUTCOME	6.83	1	6.83	2.94	0.05**
ID_ORG	13.94	1	13.94	6.00	0.01**
ID_PRO	4.07	1	4.07	1.75	0.10*
ID_CONFLICT	3.41	1	3.41	1.47	0.12
Error	134.79	58	2.32		
Total	1216.00	63			
Corrected Total	159.43	62			
a. R Squared = 0.16 (Adjusted R Squared = 0.10)					
b. Computed using alpha = 0.05					
c. ** $p < 0.05$ and * $p < 0.10$					

Source: Authors' processing based on surveyed auditors' responses; SPSS® Statistics

Results for the Independent Samples T-test (one-tailed) are provided in **Table no. 4** and **5**. Referring back to hypothesis one (H1), we test whether the outcome effect is higher for auditors with higher organizational identity. The means and standard deviation (SD) for organizational identification with negative and positive outcome are 6.21 (0.85 SD) and 5.86 (1.22 SD), respectively. We predict and find that the outcome effect is higher in the decision of auditors with higher organizational identity. We also find that the difference between negative and positive outcome effect and organizational identification is marginally significant ($p = 0.10$).

In hypothesis two (H2), we examine if the outcome effect is lower with auditors who have higher levels of professional identification. The means and standard

deviation for professional identification with the negative and positive outcome are 6.24 (0.92 SD) and 5.69 (1.63 SD), respectively. We predict and find that the outcome effect is lower for auditors with higher levels of professional identity. We also find that the difference between negative and positive outcome effect and professional identification is statistically significant ($p = 0.05$). In hypothesis three (H3), we assess if identification conflict of organization and profession decreases (increases) the influence of positive (negative) outcome bias on experts' judgements. According to Leech, Barrett, and Morgan (2011), since the results for the ANOVA for the ID_CONFLICT were not marginally significant, we must reject hypothesis three. These results for H1 and H2 are better clarified and discussed below using figures.

Table no. 4. Group Statistics

	OUTCOME	N	Mean	Standard Deviation
ID_ORG	Negative	34	6.21	0.845
	Positive	29	5.86	1.217
ID_PRO	Negative	34	6.24	0.923
	Positive	29	5.69	1.628
ID_CONFLICT	Negative	34	3.76	1.908
	Positive	29	4.93	1.831

Source: Authors' processing based on surveyed auditors' responses; SPSS® Statistics

Table no. 5. Independent Samples T-test

Variables	Variance Assumption	T	Df	Sig. (1-tailed)	Mean Difference	Std. Error Difference
ID_ORG	Equal variances assumed	1.32	61	0.10*	0.34	0.26
	Equal variances not assumed	1.28	48.77	0.10*	0.34	0.27
ID_PRO	Equal variances assumed	1.67	61	0.05**	0.55	0.33
	Equal variances not assumed	1.60	42.74	0.06*	0.55	0.34
ID_CONFLICT	Equal variances assumed	-2.46	61	0.01**	-1.17	0.47
	Equal variances not assumed	-2.47	60.12	0.01**	-1.17	0.47

Source: Authors' processing based on surveyed auditors' responses; SPSS® Statistics

4. Discussion

We accept H1 and H2, but not H3. To better understand the impact of the outcome effect and its relationship with organizational identification and professional identification we created **Figures 1 and 2**. To create the figures, we adapted the data points on the 7-point Likert-type scale to where participants' organizational

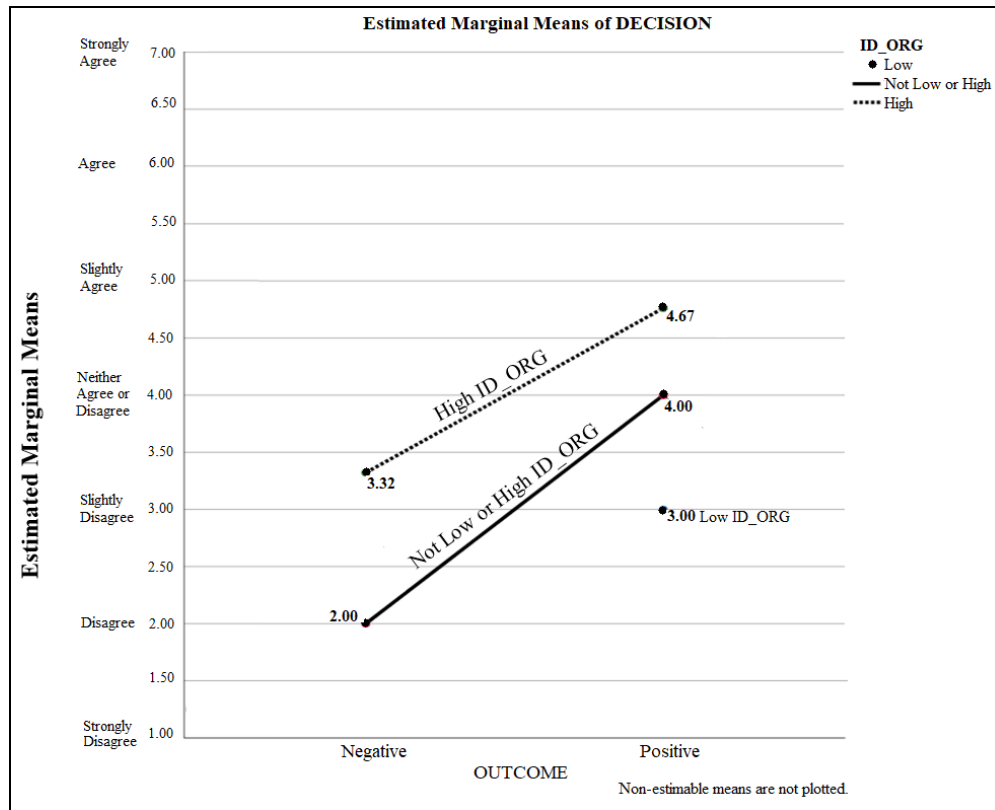
identity (ID_ORG) and professional identity (ID_PRO) responses were made into categories: (1) response values from one through three are coded as "1" and "Low"; (2) response values of four are coded as "2" and "Not Low or High"; and (3) response values from five through seven are coded as "3" and "High."

Simply looking at the numerical results does not adequately provide the context of the results. In the

survey scenario, a lead engagement partner (LEP) assessed a client for goodwill impairment and agreed with the client's management that their new product line's estimated six percent annual growth was plausible. In today's economy, it would be difficult for any company to sustain a six percent annual growth for a sporting goods product line. The LEP's decision resulted in the client not recording a goodwill

impairment. Auditor participants were asked to evaluate the same documentation as the LEP, were given outcome information, and asked to respond to a statement on the previously mentioned Likert-type scale. The negative information stated that the projected annual growth rate had not been met while the positive information stated the annual sales had been met.

Figure no. 1. Organizational Identity (ID_ORG) Across Outcome (OUTCOME)



Source: Authors' processing based on surveyed auditors' responses; SPSS® Statistics

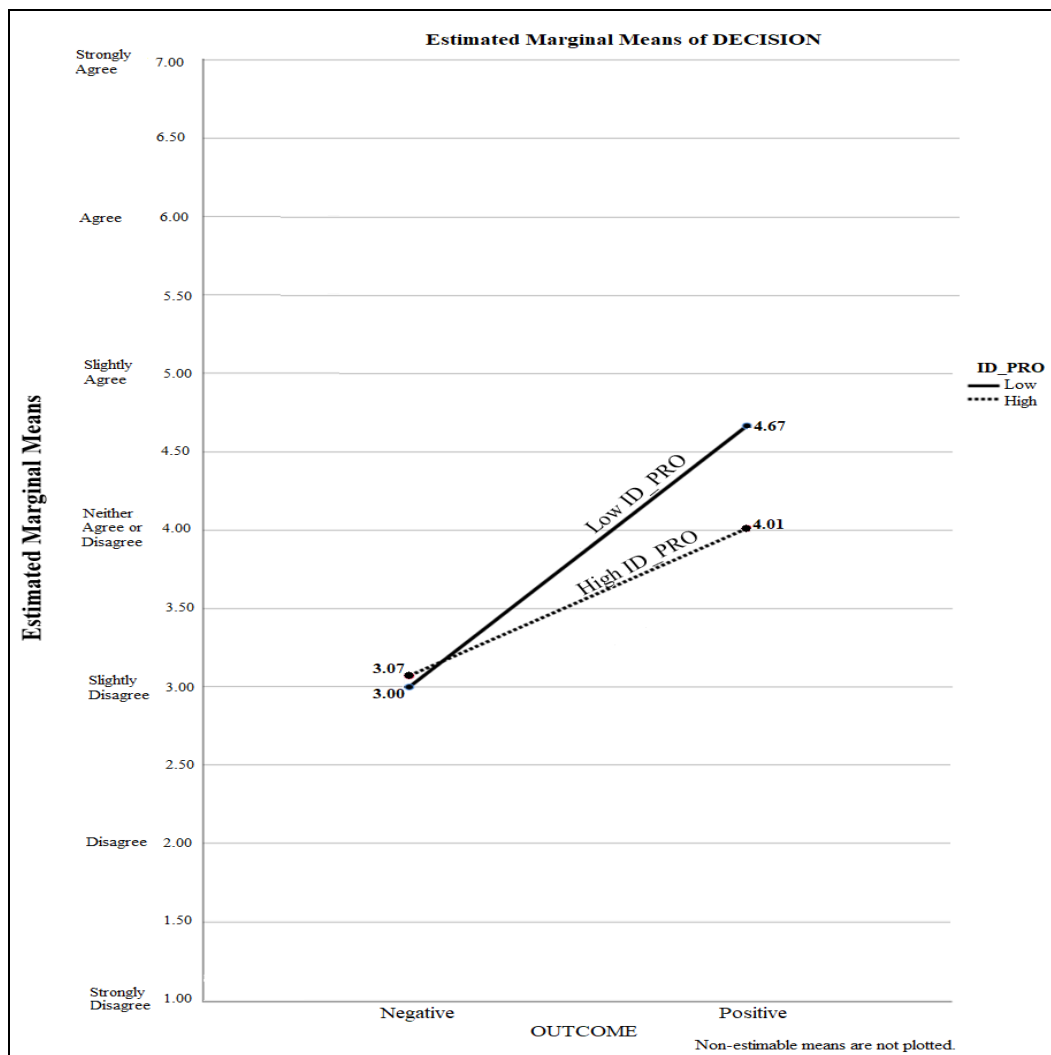
Figure no. 1 is a visual representation of H1. Once the values are disentangled, we clearly see that decisions of auditors with high organizational identity are more likely to slightly disagree with their peer when given negative outcome information (average of 3.32) where those who are given positive information (average of 4.67) are more likely to slightly agree. If the outcome effect and organizational identity had no impact on the decision, the response averages would be four or "Neither Agree or Disagree" (this point is also neutral). This conclusion is further supported by the presentation of the lines for

"Not Low or High" and the point for "Low." Decisions of auditors with average (not low or high) organizational identity are still likely to disagree when negative information (average of 2.00) is presented, yet are neutral when positive information (average of 4.00) is provided. We did not have any participants with low identification that were given negative information. Interestingly, the participants with low organizational identification and given positive outcome information are more likely to disagree with their peer's decision. These results are consistent with prior literature which suggests

that individuals with high organizational identity are more likely to make decisions that are favorable to or

protective of their employing firm (Bamber and Iyer, 2002).

Figure no. 2. Professional Identity (ID_PRO) Across Outcome (OUTCOME)



Source: Authors' processing based on surveyed auditors' responses; SPSS® Statistics

Figure no. 2 represents auditors' professional identification across negative versus positive outcome effect. Similar to the values provided in the prior figure, the 4 value represents a neutral position or "Neither Agree or Disagree" with the lead engagement partner's decision. Note that subjects with a high and low professional identification who received negative information have a 3.07 and 3.00, respectively, and are more likely to disagree slightly. Interestingly, positive

outcome information impacts the decisions of auditors with low professional identity (average of 4.67) more so that those with high professional identity (average of 4.01). Overall, the outcome effect has less impact on the decision of auditors when professional identity is present at a low level. Notice that all the response averages are close to 4 or neutral. Thus, it appears that professional identification may minimize the impact of the outcome effect.

Overall, the results suggest that upper management of accounting firms should consider implementing techniques to increase auditors' professional identification, for the individuals with these qualities appear to be less impacted by outcome effect, regardless of the type (negative versus positive) information. They may also want to consider implementing techniques that will minimize organizational identification.

Conclusion

The results of this study provide the support that professional identification can minimize the influence of the outcome effect where organizational identification appears to have a detrimental impact. Professional identification is a slightly better tool for mitigating the effects of negative and positive outcome knowledge on auditors' decisions. Given that there can be adverse impacts associated with an auditor's identification with the firm audited, including increased organizational-professional conflict, these results should be considered within the context of the auditing profession's ethos. The auditing profession should continually strive to elevate auditors' level of professional identification to ensure that auditor judgements remain unbiased and not influenced by either organizational ties or outcome knowledge. Similarly, these results suggest that it would behoove an organization to cultivate a professional-oriented culture

since it is more likely to assist auditors and minimize biases.

While the sample size for this study was relatively large for experimental studies using professional auditors, the size limited the ability of the authors to examine the outcome effect by auditor rank or experience. All participants in this study are audit professionals; therefore, these results may not be generalizable to participants that fill multiple roles within a firm while serving clients. Prior research finds that professionals in tax preparation roles are more likely to be an advocate for their client (Pinsker, Pennington, and Schafer 2009). A topic for future research may be to examine whether identity differs for professionals filling more than one professional role. Based on Shanteau (2000), professional experts' decisions will be within consensus of those of other experts. Hence, we believe these results are only generalizable to audit professionals with ten years or more experience, such as those who are represented in our population. A future area of research may be the impact of the identification and outcome effect on less experienced auditors. Also, this study focused on the broader question of organizational identification and professional identification's impact on the use of outcome knowledge when rendering an audit judgement. Examining whether auditor experience and rank influence the relationship between identification and outcome effect would offer insight for management when establishing auditing teams.

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